

BEFORE THE DEPARTMENT OF REVENUE
OF THE STATE OF MONTANA

In the matter of the adoption of New)	NOTICE OF PUBLIC HEARING ON
Rules I through XI, amendment of)	PROPOSED ADOPTION,
ARM 42.15.108 and 42.15.301, and)	AMENDMENT, AND REPEAL
repeal of ARM 42.15.407 and)	
42.17.316 pertaining to fiduciaries,)	
estates, and trusts)	

TO: All Concerned Persons

1. On August 10, 2015, at 1:30 p.m., the Department of Revenue will hold a public hearing in the Third Floor Reception Area Conference Room of the Sam W. Mitchell Building, located at 125 North Roberts, Helena, Montana, to consider the proposed adoption, amendment, and repeal of the above-stated rules. The conference room is most readily accessed by entering through the east doors of the building.

2. The Department of Revenue will make reasonable accommodations for persons with disabilities who wish to participate in this public hearing or need an alternative accessible format of this notice. If you require an accommodation, please advise the department of the nature of the accommodation needed, no later than 5 p.m. on July 27, 2015. Please contact Laurie Logan, Department of Revenue, Director's Office, P.O. Box 7701, Helena, Montana 59604-7701; telephone (406) 444-7905; fax (406) 444-3696; or e-mail lalogan@mt.gov.

3. The department is proposing the rules in this notice to provide guidance and answers to questions frequently received from fiduciaries regarding their filing requirements. In most cases, the filing requirements for fiduciaries in Montana are established by federal law and the proposed rules will clarify this relationship for several types of trusts. The goal is to reduce confusion for fiduciaries who manage estates and trusts within a complex legal setting.

The department seeks to add consistency within the rules by aligning language from current rules together with the proposed new rules, eliminating duplication, and placing the relevant information together in a new, single chapter to enable the fiduciaries to readily locate the information.

Specific detail is included in the reasonable necessity statement provided for each proposed rule action below.

4. The rules as proposed to be adopted provide as follows:

NEW RULE I DEFINITIONS The following definitions apply to terms used in this chapter:

- (1) "Beneficiary" means a person who:
 - (a) is a beneficiary as defined in 72-38-103, MCA; or
 - (b) is a devisee or heir of a decedent's estate.

(2) "Business trust" means any entity that is a business trust as defined in 35-5-101, MCA, or that is formed with a trust instrument and taxed as a corporation, partnership, or sole proprietorship for federal income tax purposes.

(3) "Charitable trust" means a trust or portion of a trust created for a charitable purpose as provided in 72-38-405(1), MCA. Common forms of trusts that include both a private and a charitable element are charitable remainder annuity trusts (CRAT), charitable remainder unitrusts (CRUT), charitable lead annuity trusts (CLAT), charitable lead unitrusts (CLUT) and pooled income funds.

(4) "Common trust fund" has the meaning given the term "common trust fund" in section 584 of the Internal Revenue Code (IRC) and IRS regulation section 1.6032-1. This generally means a fund maintained by a bank exclusively for the collective investment or reinvestment of monies contributed by the bank in its capacity as a fiduciary or custodian and in conformity with the rules and regulations of the Board of Governors of the Federal Reserve System or the Comptroller of Currency pertaining to the collective investment of trust funds by national banks. To the extent that anything in this definition appears to conflict with the IRC or regulations, the IRC and regulations control.

(5) "Electing small business trust (ESBT)" has the meaning given the term "electing small business trust" in IRC section 1361. This generally includes any trust if:

(a) the trust does not have as a beneficiary any person other than an individual, estate, or organization described in IRC section 170(c), or an organization which holds a contingent interest in such trust and is not a potential current beneficiary;

(b) no interest in such trust was acquired by purchase; and

(c) the trust has an election under IRC section 1361(e). To the extent that anything in this definition appears to conflict with the IRC, the IRC controls.

(6) "Foreign estate" has the meaning given the term "foreign estate" in IRC section 7701. This generally means an estate the income of which, from sources without the United States which is not effectively connected with the conduct of a trade or business with the United States, is not includible in gross income under IRC subtitle A.

(a) To the extent that anything in this definition appears to conflict with the IRC, the IRC controls.

(7) "Foreign trust" has the meaning given the term "foreign trust" in IRC section 7701. This generally means any trust other than a trust:

(a) over which a court within the United States is able to exercise primary supervision over its administration; and

(b) one or more United States persons have the authority to control all substantial decisions of the trust. To the extent that anything in this definition appears to conflict with the IRC, the IRC controls.

(8) "Grantor trust" means that the income or gains of the trust are taxable to the grantor or others treated as substantial owners under IRC sections 671 to 679.

(9) "Gross income of the estate or trust" means all income of the estate or trust as provided in 15-30-2152, MCA, and in [NEW RULE IV].

(10) "Irrevocable trust" means a trust that cannot be modified or terminated except as provided in 72-38-411, MCA.

(11) "Nonresident estate" means an estate other than a resident estate.

(12) "Nonresident trust" means a trust other than a resident trust.

(13) "Pre-need funeral trust" means funds set aside in a trust account held by a trustee to fund a pre-need funeral contract or agreement as defined in ARM 24.147.302. In most cases a pre-need funeral trust is also a "qualified funeral trust (QFT)." A QFT is defined in IRC section 685, for which the trustee has elected to file federal Form 1041-QFT, U.S. Income Tax Return for Qualified Funeral Trusts.

(14) "Qualified subchapter S trust (QSST)" has the meaning given the term QSST in IRC section 1361(d)(3). This generally means a trust in which all of the income is distributed or required to be distributed currently to one individual who is a citizen or resident of the United States, and with terms requiring that:

(a) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust;

(b) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary;

(c) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust; and

(d) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary. To the extent that anything in this definition appears to conflict with the IRC, the IRC controls.

(15) "Resident estate" means an estate of a decedent who was a Montana resident at the time of the decedent's death.

(16) "Resident trust" means any trust that is principally administered in Montana and includes, but is not limited to:

(a) any trust that designates Montana as its principal place of administration, as defined in 72-38-103 and 72-38-108, MCA;

(b) any trust that is primarily administered by a trustee or representative who is a Montana resident or whose principal place of business is located in Montana;

(c) any irrevocable trust created by, or consisting of property of, a Montana resident on the date the trust or portion of the trust became irrevocable and has at least one income beneficiary who, for all or some portion of the trust's current taxable year, was a Montana resident;

(d) any trust created by the will of a decedent who was a Montana resident at the time of the decedent's death; and

(e) any trust created by, or caused to be created by, a court as a result of the death of an individual when:

(i) property was transferred to an irrevocable inter vivos trust as a result of a decedent's death;

(ii) the decedent was a Montana resident at the time of the decedent's death; and

(iii) the trust has at least one income beneficiary who, for all or some of the trust's current taxable year, was a Montana resident.

(17) "Revocable trust" means any portion of a trust for which the power to revest title in the grantor is exercisable at any time by the trustor or a nonadverse party.

(18) "Simple trust" means a trust with terms that provide that all the net income must be distributed on an annual basis and do not provide that any amounts are to be paid, permanently set aside, or used for charitable purposes as specified in IRC section 642(c).

(19) "Split-interest trust" means a trust as provided in IRC section 4947, and includes a charitable remainder trust as provided in IRC section 664, a pooled income fund as provided in IRC section 642, charitable lead trust, grantor retained annuity trust (GRAT), grantor retained unitrust (GRUT), and grantor retained income trust (GRIT).

(20) "Supplemental needs trust" or "special needs trust" means a trust that was created for the benefit of a disabled beneficiary and under which the trust assets are not included in the beneficiary's asset or income base for purposes of government benefits such as Medicaid or supplemental security income as provided in 42 U.S.C. 1396p(d)(4).

(21) "Testamentary trust" means a trust that is created by a will and begins its existence when property is transferred from the decedent's estate to the trust. A testamentary trust is irrevocable and can either be a simple or complex trust.

(22) "Trust" means any entity that is classified as a trust for federal income tax purposes and includes a designated settlement fund as provided in IRC section 468B.

AUTH: 15-1-201, 15-30-2104, 15-30-2620, MCA

IMP: 15-30-2104, 15-30-2151, 15-30-2152, 15-30-2153, 15-30-2154, 15-30-2602, 15-30-2603, MCA

REASONABLE NECESSITY: The department proposes adopting New Rule I to provide necessary and helpful definitions as part of a new chapter to be added within ARM Title 42 that will house the proposed new rules contained in this hearing notice. It is the department's intent to place all of the fiduciary-related information together in a dedicated chapter for ease of reference by fiduciaries and tax return preparers.

As Senate Bill 251, L. 2013, codified common law applicable to trusts, the proposed definitions promote consistency by utilizing the commonly used terms contained in the Uniform Trust Code. This proposed definitions rule will also help fiduciaries and tax return preparers determine how various Internal Revenue Code and Montana statute provisions affect the Montana tax filing requirements of estates and trusts.

NEW RULE II FIDUCIARY – FILING REQUIREMENTS (1) Subject to (4), a fiduciary for a resident estate or resident trust is required to file a Montana Income Tax Return for Estates and Trusts (Form FID-3) if:

(a) the gross income of the estate from all sources exceeds an exemption allowance, regardless of any tax liability;

(b) the gross income of the trust from all sources exceeds an exemption allowance;

(c) the trust has any taxable income; or

(d) the estate or trust is filing a final year return.

(2) Subject to (4), a fiduciary for a nonresident estate, nonresident trust, part-year resident estate or part-year resident trust that has any item of income, gain, loss, and/or deduction derived from or connected with sources in Montana (including, but not limited to, a Montana trustee's intangible interest in a nonresident trust) is required to file a Form FID-3 if:

(a) the gross income of the estate from all sources exceeds an exemption allowance, regardless of any tax liability;

(b) the gross income of the trust from all sources exceeds an exemption allowance;

(c) the trust has any taxable income; or

(d) the estate or trust is filing a final year return.

(3) Form FID-3 is due on or before the 15th day of the fourth month following the close of the tax year of the estate or trust. If the due date falls on a weekend or holiday, the return is due the next business day.

(4) An estate or trust with a filing requirement as provided in (1) and (2) must complete a Form FID-3, unless otherwise provided in the following:

(a) A bankruptcy estate of an individual must file a Form FID-3, but complete only the heading portion and report the amount of tax computed on the attached copy of the individual's Montana tax return. Credits and payments that are applicable to the bankruptcy estate are reported on Form FID-3.

(b) A bankruptcy estate of a married couple filing jointly must file a Form FID-3, but complete only the heading portion and report the amount of tax computed on the attached copy of the joint Montana tax return. A married couple cannot use the filing status of married filing separately on the same return to determine their separate Montana income tax liabilities for a bankruptcy estate. If a married couple does not file a joint return, but both spouses are filing for bankruptcy individually, then each spouse will complete a separate Form FID-3 and an individual Montana income tax return. Credits and payments that are applicable to the bankruptcy estate are reported on Form FID-3.

(c) A business trust must file the following returns:

(i) a Montana Corporate Income Tax Return (Form CIT) if the trust files a U.S. Corporation Income Tax Return (Form 1120);

(ii) a Montana Partnership Information and Composite Tax Return (Form PR-1) if the trust files a U.S. Return of Partnership Income (Form 1065);

(iii) a Montana S Corporation Information and Composite Tax Return (Form CLT-4S) if the trust files a U.S. Income Tax Return for an S Corporation (Form 1120S); and

(iv) a Montana Disregarded Entity Information Return (Form DER-1) if the trust is a disregarded entity.

(d) A common trust fund that files a U.S. Return of Partnership Income (Form 1065) must file a Montana Partnership Information and Composite Tax Return (Form PR-1).

(e) An electing small business trust is subject to special filing requirements as provided in [NEW RULE X].

(f) A foreign decedent's estate has the same filing requirements as a nonresident estate as provided in (2).

(g) A foreign trust has the same filing requirements as a nonresident trust as provided in (2).

(h) A pre-need funeral trust is subject to special filing requirements as provided in [NEW RULE IX].

(i) If an entire trust is a grantor trust, the fiduciary must file a Form FID-3 but complete only the heading portion and report the trust's activity on a separate supporting statement. The supporting statement and a complete copy of the federal Form 1041 must be included with Form FID-3. If the fiduciary is not the grantor, then the fiduciary must provide a copy of Form FID-3 and the supporting statement to the grantor.

(j) If only part of a trust is a grantor trust, the fiduciary must report the activity attributable to the grantor trust as provided in (i) and report the activity not attributable to the grantor trust on a form prescribed by this rule.

(k) A qualified settlement fund or designated settlement fund that is treated as a corporation for federal income tax purposes and that files a U.S. Income Tax Return for Settlement Funds (Form 1120-SF) must file a Montana Corporate Income Tax Return (Form CIT).

(l) A split-interest trust must file Form FID-3, but complete only the heading portion and report the trust's activity on a separate supporting statement, rather than on Form FID-3. The supporting statement and a complete copy of the federal Split-Interest Trust Information Return (Form 5227) must be included with the Form FID-3.

(m) If an entire trust is a qualified subchapter S trust (QSST), the fiduciary must file a Form FID-3 but complete only the heading portion and report the trust's activity on a separate supporting statement. The supporting statement and a complete copy of the federal Form 1041 must be included with Form FID-3.

(n) If only part of a trust is a QSST, the fiduciary must report the activity attributable to the QSST as provided in (m) and report the activity not attributable to the QSST on a form prescribed by this rule.

(o) A tax-exempt trust is subject to special filing requirements as provided in [NEW RULE VIII].

(5) If a fiduciary is required to file Form FID-3, then a copy of the U.S. Income Tax Return for Estates and Trusts (Form 1041) must be submitted on paper or electronically with Form FID-3 as follows:

(a) if filing on paper, then the fiduciary must include copies of the federal schedules that substantiate gross income, deductions, and ordinary or throwback distributions to beneficiaries; or

(b) if filing Form FID-3 electronically, then the fiduciary must provide a complete copy of the federal income tax return with all accompanying schedules and statements to the department if requested.

(6) If a fiduciary is not required to, or does not, file a federal tax return for a tax year for which they are required to file a Form FID-3, the fiduciary must compute federal adjusted total income, complete the applicable federal forms and schedules and submit a copy of the forms and schedules with the Form FID-3. The words "Pro Forma" must be clearly marked at the top of the federal forms and schedules.

(7) If the fiduciary of a decedent's estate is filing for a short tax year and the applicable tax forms are not available, the fiduciary may use the prior year's tax forms. If the fiduciary uses the prior year's tax forms, the fiduciary must incorporate

any tax law changes that are effective for the applicable tax year but may use the prior year's exemption amount and tax rate brackets. A short-year tax return may not be filed electronically.

(8) The guardian of a ward who has income files an individual income tax return on behalf of the ward.

AUTH: 15-1-201, 15-30-2104, 15-30-2603, 15-30-2620, MCA

IMP: 1-1-307, 15-30-2104, 15-30-2114, 15-30-2151, 15-30-2602, 15-30-2603, 15-30-2619, 15-31-101, 15-31-102, MCA

REASONABLE NECESSITY: The department proposes adopting New Rule II to identify the filing requirements of a decedent's estate, a bankruptcy estate, and numerous types of trusts. Even though Montana law provides that, in general, individual income tax rules apply to estates and trusts, numerous questions have arisen about what income thresholds, if any, apply to both resident and nonresident estates and trusts. The proposed rule explains that fiduciaries who file a Montana Income Tax Return for Estates and Trusts (Form FID-3) must consider several factors to determine if an estate or trust has a filing requirement, such as the amount of gross income, if gross income includes taxable income, and if the estate or trust is filing a final year return.

As proposed, New Rule II also addresses questions regarding the multiple estates and trusts with special federal filing requirements and how the department will address those requirements. Not all fiduciaries are required to file Form FID-3. The proposed rule establishes that bankruptcy estates of an individual will file an individual income tax return in addition to a Form FID-3, a business trust and common trust fund should file a return which corresponds to its federal filing status, and a foreign estate and a foreign trust will be treated as a nonresident for Montana income tax filing requirements. The proposed rule further provides guidance for grantor trusts, qualified settlement funds, and split-interest trusts.

The proposed rule allows fiduciaries to timely file short-year tax returns for decedent's estates. Previously, fiduciaries would have to file short-year tax returns on prior year's forms, but then the return could not be processed until the current year forms were available. As proposed, New Rule II establishes that fiduciaries can use a prior year tax return form to complete any required filings and the department can process the return timely.

NEW RULE III FIDUCIARY - INCOME TAX RETURN EXTENSIONS (1) A fiduciary is allowed an automatic six-month extension to file a Montana Income Tax Return for Estates and Trusts (Form FID-3) if:

- (a) the current year's tax liability is \$200 or less and the entire tax liability is paid by the extended due date of the return; or
 - (b) the fiduciary has paid, through withholding, estimated tax payments or a combination of withholding and estimated tax payments, at least:
 - (i) 90 percent of the current year's tax liability by the due date of the return; or
 - (ii) 100 percent of the prior year's tax liability by the due date of the return.
- (2) For purposes of this rule the tax liability and amount of payment are determined as provided in ARM Title 42, chapter 17, subchapter 3.

(3) If a fiduciary is required to file Form FID-3, then the fiduciary is considered to have paid 100 percent of the previous year's tax for purposes of (1) if the estate or trust is a first-time filer or the estate or trust had zero or negative taxable income the previous year.

(4) If a fiduciary is required to file a return other than Form FID-3, then the extension rules for the return that the fiduciary is filing must apply. For example, if the fiduciary is required to file a Montana Partnership Information and Composite Tax Return (Form PR-1), then the extension rules that apply to filers of Form PR-1 will also apply to the fiduciary that is required to file a Form PR-1.

AUTH: 15-1-201, 15-30-2104, 15-30-2603, MCA

IMP: 15-30-2154, 15-30-2604, MCA

REASONABLE NECESSITY: The department proposes adopting New Rule III to establish guidance for fiduciaries and tax preparers who need to extend the filing of a tax return for an estate or trust. The department often receives questions about which extension rules apply to the different estates and trusts. As proposed, New Rule III will establish that the extension rules that apply to individual filers will also apply to fiduciaries if the required return is a Montana Income Tax Return for Estates and Trusts (Form FID-3). However, if the required return is not a Form FID-3, the proposed rule explains that the applicable extension rules depend upon what type of return must be filed for the trust.

NEW RULE IV FIDUCIARY - INCOME TAX LIABILITY DETERMINATION

(1) This rule applies to fiduciaries that are required to file a Montana Income Tax Return for Estates and Trusts (Form FID-3). If a fiduciary is required to file a different tax return for an estate or trust, then the tax will be determined on the required return. For example, if a fiduciary files a Montana Corporate Income Tax Return (Form CIT) for a business trust, then the tax liability for the business trust will be determined using Form CIT.

(2) Federal adjusted total income of the estate or trust is adjusted for Montana additions and subtractions as provided in (3) and 15-30-2152, MCA, to arrive at Montana adjusted total income.

(3) The Montana additions to federal adjusted total income of an estate or trust include, but are not limited to:

(a) recoveries of amounts claimed as deductions on a prior year's tax return that reduced Montana taxable income, such as a casualty loss reimbursement;

(b) health insurance premiums used to calculate the Insure Montana small business health insurance credit;

(c) expenses allocated to federal obligations that are not allowed as a deduction for Montana purposes; and

(d) other items properly included in Montana taxable income that are not included in federal taxable income, such as distributions to an estate from an employee's pension or retirement plan that are subject to Montana tax at the time of distribution.

(4) The Montana subtractions from federal adjusted total income of an estate or trust include, but are not limited to:

(a) state tax refunds included in federal taxable income. Montana income tax refunds and income tax refunds received from another state are not taxable to Montana;

(b) refund, credit, offset, or other recovery of an amount deducted in an earlier year that was included in federal taxable income but did not reduce Montana taxable income;

(c) pension or annuity income exempt from tax as provided in 15-30-2110, MCA;

(d) federal taxable Railroad Retirement Board Tier I and Tier II benefits; and

(e) deductible expenses allocated to other states' interest and mutual fund dividends such as expenses related to interest income from non-Montana municipal securities includable in Montana taxable income.

(5) Montana adjusted total income is reduced, but not below zero, by any Montana income distribution as determined in [NEW RULE V].

(6) An estate or trust is allowed one personal exemption as provided in 15-30-2152, MCA.

(7) Resident estates and trusts pay tax on all of their income and are entitled to claim a credit for taxes paid to other states on the same income as provided in 15-30-2302, MCA, and ARM 42.4.401 through 42.4.404.

(8) Nonresident and part-year resident estates and trusts compute a tentative tax as if they are resident estates or trusts, and then determine their Montana income tax liability by multiplying the tentative tax by the ratio of their Montana source income to their income from all sources as provided in 15-30-2104, MCA.

(9) Nonresident estates and trusts cannot claim a credit for taxes paid to other states against their Montana income tax liability.

AUTH: 15-1-201, 15-30-2104, 15-30-2620, MCA

IMP: 15-30-2104, 15-30-2110, 15-30-2151, 15-30-2152, 15-30-2153, 15-30-2603, MCA

REASONABLE NECESSITY: The department proposes adopting New Rule IV to specify the distinct principal steps that are involved in determining the taxable income of an estate or trust because, while estates and trusts are generally subject to the rules that apply to individuals, important differences exist. The proposed rule explains the differences by identifying at what stage in the preparation of a fiduciary return adjustments should be made to total federal income of an estate or trust.

NEW RULE V FIDUCIARY - MONTANA DISTRIBUTABLE NET INCOME AND MONTANA INCOME DISTRIBUTION DEDUCTION – CHARACTER

(1) Montana distributable net income (DNI) limits the deduction that a decedent's estate or trust may claim for aggregate distributions to beneficiaries and determines how much of the distribution has to be included in the beneficiaries' gross income.

(2) Montana DNI is computed in the same way distributable net income is computed for federal income tax purposes under Internal Revenue Code section 643, but with Montana adjustments to income as provided in 15-30-2152, MCA, and [NEW RULE IV].

- (3) Decedent's estates and trusts are allowed to deduct the lesser of:
- (a) the amounts of income actually distributed, including other amounts paid, credits, or amounts otherwise required to be distributed; or
 - (b) the taxable portion of Montana DNI.
- (4) If a decedent's estate or trust elects for federal income tax purposes to treat distributions made within 65 days after the end of the tax year as having been made in the tax year, the decedent's estate or trust must also treat the distributions as having been made in the tax year for Montana income tax purposes.
- (5) Income distributed to a beneficiary from a decedent's estate or trust retains the same character in the hands of the beneficiary as it had in the hands of the decedent's estate or trust, with the exception of unused capital loss distributed upon closure of the decedent's estate or trust to a corporation, which is treated as a short-term loss regardless of its character in the decedent's estate or trust.
- (6) Unless the will or trust instrument specifically provides otherwise, a distribution to beneficiaries is considered to be a proportionate distribution of the different kinds of income composing the Montana DNI of the estate or trust. The same character and proportionate distribution rule is illustrated by the following example:
- (a) Decedent A, a resident of Montana, died February 15, 2016. Under the terms of the will, all the decedent's property was divided in equal shares to beneficiary B, a resident of Arizona, and beneficiary C, a resident of Montana. The estate adopted a calendar year as its taxable year. For calendar year 2016, the estate had Montana DNI of \$50,000, which is composed of:

DNI	
Interest Income	\$10,000
Dividend Income	\$ 5,000
Net Montana Farm Income	\$35,000
Total	\$50,000

- (b) On December 20, 2016, the estate distributed \$12,500 to beneficiary B, and \$12,500 to beneficiary C. Beneficiaries B and C received a distribution for 2016 as follows:

Beneficiary B		Beneficiary C	
Interest Income	\$ 2,500	Interest Income	\$ 2,500
Dividend Income	\$ 1,250	Dividends	\$ 1,250
Farm Income	\$ 8,750	Farm Income	\$ 8,750
Total	\$12,500	Total	\$12,500

- (c) Since the interest income of the estate is 20 percent of the Montana DNI, 20 percent of the distribution to beneficiaries B and C is considered interest income. Likewise, 10 percent of the estate's Montana DNI is dividends and 70 percent is farm income. The estate is entitled to a distribution deduction of \$25,000 against gross income in 2016 for the distribution to beneficiaries B and C and computes its own Montana income tax liability on the \$25,000 income retained in the estate; and

(i) Beneficiary C, a resident of Montana, must report the entire distribution of \$12,500 on a Montana individual income tax return; and

(ii) Beneficiary B, a resident of Arizona, is required to report the entire distribution of \$12,500 as Montana source income on a Montana individual income tax return because the income was distributed from a Montana resident estate.

AUTH: 15-1-201, 15-30-2104, 15-30-2620, MCA

IMP: 15-30-2104, 15-30-2151, 15-30-2152, 15-30-2153, 15-30-2603, MCA

REASONABLE NECESSITY: The department proposes adopting New Rule V to provide guidance for determining Montana distributable net income (DNI) and the Montana income distribution deductions. If these amounts are not adjusted for Montana income tax purposes, then a distortion would exist between the calculation of the Montana adjusted total income and the deductions allowed to determine taxable income of an estate or trust. As proposed, New Rule V explains how the characterization and sourcing rules apply when determining the type of income and whether the income constitutes Montana source income to aid preparers in properly completing returns and reports for estates, trusts, and beneficiaries and provides a helpful example.

NEW RULE VI FIDUCIARY - INTEREST AND PENALTIES (1) If a fiduciary is required to file a return other than a Montana Income Tax Return for Estates and Trusts (Form FID-3), then the interest and penalties that are calculated on the applicable tax return will apply to the fiduciary's filing of the same return. For example, if the fiduciary is required to file a Montana Corporate Income Tax Return (Form CIT) for a trust, then any interest and penalties that the fiduciary would be liable for will be calculated as though the trust was a corporation.

(2) If a fiduciary is required to file Form FID-3:

(a) late payment penalties and late filing penalties will be applied as provided in 15-1-216, MCA;

(b) interest on unpaid tax will accrue from the original due date of the return as provided in 15-1-216, MCA, unless the current year's tax liability is \$200 or less and the entire tax liability is paid by the extended due date; and

(c) underpayment interest, as provided in 15-30-2512, MCA, will accrue from the original due date of the return unless the tax liability is \$200 or less and the entire tax liability is paid by the extended due date.

(3) Fiduciaries that are required to file Form FID-3 are subject to underpayment interest as provided in 15-30-2512, MCA.

(4) Fiduciaries that are required to file Form FID-3 are required to make estimated tax payments as provided in 15-30-2512, MCA.

AUTH: 15-1-201, 15-30-2104, MCA

IMP: 15-1-216, 15-30-2512, 15-30-2604, MCA

REASONABLE NECESSITY: The department proposes adopting New Rule VI to address questions received regarding the calculation of interest and penalties for fiduciaries. Not all fiduciaries who have a filing requirement must file a Montana

Income Tax Return for Estates and Trusts (Form FID-3). The proposed rule provides guidance to fiduciaries for the calculation of penalties and interest. The penalties and interest are calculated according to the type of return the fiduciary must file.

NEW RULE VII FIDUCIARY - MONTANA NET OPERATING LOSSES

(1) Amounts used to calculate a Montana net operating loss (NOL) for decedents' estates and trusts cannot be distributed to a beneficiary as reportable tax items on the beneficiary's Montana tax return unless the distribution occurs with the filing of the final year return as provided in Internal Revenue Code (IRC) section 642(h) and 26 CFR 1.642(h)-1. If any excess NOL deduction can be distributed to the beneficiaries, the distribution must be part of the excess Montana NOL deduction, not the excess federal NOL deduction.

(2) A decedent's estate or trust has a Montana NOL if Montana taxable income, recomputed with the adjustments provided in IRC section 172(d), is less than zero. To recompute Montana taxable income, the following must be added back:

- (a) any net operating loss deduction;
- (b) any deduction for an exemption provided in 15-30-2152, MCA;
- (c) any gain excluded from the sale or exchange of qualified small business stock pursuant to IRC section 1202;
- (d) the amount by which a deduction for losses from sales or exchanges of capital assets exceeds the amount includable for gains from sales or exchanges of capital assets;
- (e) the amount by which nonbusiness deductions exceed nonbusiness income;
- (f) the domestic production activities deduction;
- (g) total charitable deductions; and
- (h) the income distribution deduction.

(3) To determine the portion of a deductible expense attributable to income from a trade or business, the expense must be multiplied by the ratio of net income from the trade or business to Montana adjusted gross income. When calculating the portion of federal tax attributable to trade or business income, the ratio must be calculated using the net business income and Montana adjusted total income for the year the federal tax was incurred.

(4) An election to waive the carryback of an NOL loss for an estate or trust is irrevocable. If a fiduciary elects to waive the carryback, the election must be made by the due date (including extensions of time) for filing the estate or trust's tax return in the tax year of the NOL.

(5) This rule is effective for tax years beginning after December 31, 2015.

AUTH: 15-1-201, 15-30-2104, 15-30-2620, MCA

IMP: 15-30-2119, 15-30-2152, MCA

REASONABLE NECESSITY: The department proposes adopting New Rule VII to provide guidance to fiduciaries who are filing returns for estates and trusts with net operating losses (NOLs). Prior to this guidance in rule, the department had

instructed filers to use the federal NOL deduction and forgo calculating a separate NOL for Montana income tax purposes. Some filers requested the ability to calculate a Montana NOL rather than use the federal NOL deduction because the general NOL deduction did not reflect income or loss adjustments or the different Montana exemption allowance. Proposed New Rule VII also provides guidance for the distribution of NOL deduction amounts.

NEW RULE VIII TAX EXEMPT TRUSTS NOT CLASSIFIED AS CORPORATIONS (1) If a trust is held for educational, charitable, or religious purposes and is not classified as a corporation under 15-31-101, MCA:

(a) Montana individual income tax is not imposed on the fiduciary or the beneficiaries; and

(b) corporate income tax is imposed only on the trust's unrelated business taxable income and must be paid by the fiduciary as provided in (4).

(2) Subject to (3), if a trust, that is not classified as a corporation under 15-31-101, MCA, is part of a stock-bonus, pension, or profit-sharing plan for the exclusive benefit of some or all of the employer's employees, and the employer and employee contributions and earnings are accumulated by the trust in accordance with the plan for distribution to the employees, then:

(a) Montana individual income tax is not imposed on the fiduciary or beneficiaries when the trust receives or accrues income;

(b) Montana individual income tax is imposed on the amount of employer contributions and all trust earnings distributed or made available to the distributee in the year distributed; and

(c) corporate income tax is imposed on the trust's unrelated business taxable income and must be paid by the fiduciary as provided in (3).

(3) An otherwise tax-exempt trust that has unrelated business taxable income (UBTI), as determined for federal income tax purposes, is subject to Montana corporate income tax and is required to file a Montana corporate income tax return reporting that income if the trust's federal UBTI tax liability for the tax year exceeds \$100. To the extent the trust's UBTI is Montana source income, the trust is treated as having been engaged in business in Montana within the meaning of 15-31-101, MCA.

AUTH: 15-1-201, 15-30-2104, MCA

IMP: 15-30-2151, 15-30-2152, 15-30-2153, 15-31-101, 15-31-102 MCA

REASONABLE NECESSITY: The department proposes adopting New Rule VIII to provide specific guidance for estates and trusts that are exempt from taxation in Montana. An estate or trust that is exempt from federal income taxation is not automatically exempt in Montana. The Montana tax statutes have not been updated to specifically reference many types of trusts that are exempt from federal income tax, such as a contract issued by an insurance company that qualifies under IRC section 401(f), or a custodial account that qualifies under IRC sections 408(e), 408A, or 530. Estates and trusts that are not specifically exempted from income taxation by statute are subject to income tax in Montana.

As proposed, New Rule VIII also explains that estates and trusts that are identified as exempt are still subject to taxation if the entity has unrelated business taxable income (UBTI).

NEW RULE IX PRE-NEED FUNERAL TRUSTS – ELECTION TO FILE COMPOSITE RETURN (1) A pre-need funeral trust must file a Montana income tax return under the trust name used for filing the federal income tax return. If the fiduciary of a pre-need funeral trust is the fiduciary of more than one pre-need funeral trust and if the fiduciary elects to file a federal composite return for more than one pre-need funeral trust, the fiduciary can also elect to file a Montana composite return for the same pre-need funeral trusts as included in the federal composite return.

(2) The Montana composite return as referred to in (1) is completed on the Montana Income Tax Return for Estates and Trusts (Form FID-3) and must include a schedule reporting the following information for each separate pre-need funeral trust:

- (a) the name of the owner or the beneficiary of each pre-need funeral trust;
- (b) the type and gross amount of income earned by each pre-need funeral trust during the taxable year;
- (c) the type and amount of each deduction and credit allocable to each pre-need funeral trust;
- (d) the tax and payments made for each pre-need funeral trust; and
- (e) the termination date of each pre-need funeral trust if it was terminated during the year.

(3) The Montana composite return referred to in (1) is subject to the filing requirements of [NEW RULE II].

AUTH: 15-1-201, 15-30-2104, 15-30-2620, MCA

IMP: 15-30-2104, 15-30-2151, 15-30-2152, 15-30-2153, 15-30-2603, MCA

REASONABLE NECESSITY: The department proposes adopting New Rule IX to provide a new, simplified filing method for qualified pre-need funeral trusts that wish to file a single return for multiple trusts. The proposed new filing method allows an aggregate composite return to be elected but requires that the fiduciary provide necessary information for the department to process the composite return. The required information is the same information that the Internal Revenue Service requests of fiduciaries for pre-need funeral trusts that file a composite return federally.

NEW RULE X ELECTING SMALL BUSINESS TRUST (ESBT) (1) The portion of an ESBT that consists of stock in one or more S corporations is treated as a separate trust for purposes of determining Montana tax liability. The tax, as provided in 15-30-2153, MCA, must be calculated separately and reported on a Montana Income Tax Return for Estates and Trusts (Form FID-3).

(2) To determine Montana taxable income for the portion of the ESBT that holds S corporation stock, federal ESBT taxable income is adjusted for Montana additions to, and subtractions from, income as provided in 15-30-2152, MCA, and [NEW RULE IV]. The following are not included in this calculation:

- (a) deductions for capital losses that exceed capital gains;
- (b) an income distribution deduction;
- (c) an exemption deduction;
- (d) passive losses in excess of passive income; and
- (e) ordinary losses in excess of ordinary income.

(3) An ESBT is allowed a capital gains tax credit. If an ESBT is allowed a nonrefundable credit, such as the capital gains tax credit, items from the non-ESBT portion of the trust cannot be used to calculate the credit.

(4) If the portion of a resident ESBT that has S corporation stock receives taxable income that is sourced to multiple states or countries, the ESBT reports all taxable income in the calculation of Montana taxable income. If the resident ESBT pays income tax on income sourced to another state or country, the trust will receive a credit for income taxes paid to that other state or country as provided in 15-30-2302, MCA. If the trust is either a part-year resident or a nonresident, the trust will separately calculate tax on its Montana source income as provided in 15-30-2104, MCA.

AUTH: 15-1-201, 15-30-2104, 15-30-2620, MCA

IMP: 15-30-2104, 15-30-2111, 15-30-2112, 15-30-2151, 15-30-2152, 15-30-2153, 15-30-2603, MCA

REASONABLE NECESSITY: The department proposes adopting New Rule X to explain how the federal rules applicable to electing small business trusts (ESBTs) are applied to Montana income tax returns for estates and trusts. The Montana Legislature has not enacted legislation directing the department about any way in which it should deviate from the federal treatment of ESBTs. Without guidance, every tax return that reports ESBT activity has applied the federal rules to the filing. As proposed, New Rule X will ensure that all ESBTs can report their activity in a consistent manner.

NEW RULE XI FIDUCIARY – AUDIT ADJUSTMENTS (1) When the department adjusts the return of an estate or trust as provided in 15-30-2605, MCA, and one or more adjustments affect any Montana return filed by a beneficiary, the department may also adjust the beneficiary's return to reflect the adjustments that are allocable to the beneficiary. If a beneficiary has not filed a Montana income tax return, the department may request that the beneficiary file a return, or may estimate the beneficiary's tax liability as provided in 15-30-2512, MCA.

(2) The department will report the details of adjustments it makes to an estate or trust return to the fiduciary. If one or more items included in the income distribution deduction are affected by the adjustment, the department will also report the details of audit adjustments to the affected beneficiaries. The department will not report to a fiduciary the details of an adjustment to a beneficiary's return.

(3) The fiduciary of an estate or trust is responsible for filing all required forms and returns with the department on behalf of the estate or trust. The fiduciary of an estate or trust is also responsible for any estate or trust tax due. If there are two or more fiduciaries, the fiduciaries are jointly and severally liable.

AUTH: 15-1-201, 15-30-2104, 15-30-2620, MCA

IMP: 15-30-2151, 15-30-2512, 15-30-2601, 15-30-2605, MCA

REASONABLE NECESSITY: The department proposes adopting New Rule XI to provide guidance for a tax audit of estates and trusts. As proposed, New Rule XI explains what information can be disclosed during an audit and how the department carries an adjustment from an estate or trust tax return to a beneficiary's tax return.

Additionally, proposed New Rule XI identifies who is responsible for the filing of tax returns and the payment of any tax due, specifically that the fiduciary is responsible for filing a return for the estate or trusts and is also responsible for any tax due as a result of this filing. However, the fiduciary is not usually responsible for filing a beneficiary's return and is not personally liable for any tax due as a result of filing the beneficiary's return.

5. The rules as proposed to be amended provide as follows, new matter underlined, deleted matter interlined:

42.15.108 DETERMINING TAX LIABILITY (1) A person required to file a Montana Individual Income Tax Return must determine Montana income tax liability as provided by the applicable Montana statutes and rules. The rules for determining if an individual, whether resident for a full or part tax year, or a nonresident, must file a Montana Individual Income Tax Return, are located in ARM Title 42, chapter 15, subchapter 3.

(a) Special rules, located in ARM Title 42, chapter 15, subchapter 1, apply to certain wages of nonresident military servicepersons and enrolled tribal members.

~~(b) The rules for determining if a trust or estate must file a fiduciary return are located in ARM Title 42, chapter 15, subchapter 3. Except as otherwise specifically provided, trusts and estates are subject to all rules applicable to individuals.~~

(2) through (11) remain the same.

AUTH: 15-30-2620, MCA

IMP: 15-30-2101, 15-30-2102, 15-30-2103, 15-30-2104, 15-30-2110, 15-30-2114, 15-30-2131, 15-30-2153, MCA

REASONABLE NECESSITY: The department proposes amending ARM 42.15.108 to insert a missing word in (1) and to strike (1)(b), which contains outdated language that references rules repealed in 2004.

42.15.301 WHO MUST FILE RETURNS (1) through (3) remain the same.

~~(4) A business trust, including a REIT, is treated as a C corporation taxable under Title 15, chapter 31, MCA. See chapters 23 and 24 of Title 42, Administrative Rules of Montana, for the corporation license tax rules.~~

(5) remains the same, but is renumbered (4).

AUTH: 15-1-201, 15-30-2620, 15-31-501, MCA

IMP: 15-30-2602, 15-30-2603, 15-30-3302, 15-30-3311, 15-30-3312, MCA

REASONABLE NECESSITY: The department proposes amending ARM 42.15.301 to strike (4), which explains the filing requirements for business trusts, and placing similar language within proposed New Rule II to house related information together in a single rule in a newly created chapter in ARM Title 42.

6. The department proposes to repeal the following rules:

42.15.407 PERSONAL EXEMPTION FOR ESTATES AND TRUSTS

AUTH: 15-30-2620, MCA

IMP: 15-30-2152, MCA

REASONABLE NECESSITY: The department proposes repealing ARM 42.15.407, because proposed New Rule IV(6) more appropriately incorporates the exemption allowance into the determination of a tax liability for an estate or trust, and therefore ARM 42.15.407, will no longer serve a purpose. Only trusts that file a fiduciary income tax return are allowed a personal exemption. Some trusts must file a business return, such as a corporate income tax return or a partnership information return. An exemption allowance is not an allowable deduction on a business return. Proposed New Rule IV also explains that the allowed exemption allowance is a deduction that the estate or trust may take after an income distribution deduction is taken into account.

42.17.316 TRUSTS, ESTATES, AND FIDUCIARY RETURNS

AUTH: 15-30-2620, MCA

IMP: 15-30-2512, MCA

REASONABLE NECESSITY: The department proposes repealing ARM 42.17.316 because the same provisions are being incorporated into proposed New Rule III which will be housed together with similar subject matter in a newly created chapter of ARM Title 42. With the adoption of New Rule III, ARM 42.17.316 will become unnecessary.

7. Concerned persons may submit their data, views, or arguments, either orally or in writing, at the hearing. Written data, views, or arguments may also be submitted to: Laurie Logan, Department of Revenue, Director's Office, P.O. Box 7701, Helena, Montana 59604-7701; telephone (406) 444-7905; fax (406) 444-3696; or e-mail lalogan@mt.gov and must be received no later than August 24, 2015.

8. Laurie Logan, Department of Revenue, Director's Office, has been designated to preside over and conduct this hearing.

9. The Department of Revenue maintains a list of interested persons who wish to receive notices of rulemaking actions proposed by this agency. Persons who wish to have their name added to the list shall make a written request, which

includes the name and e-mail or mailing address of the person to receive notices and specifies that the person wishes to receive notice regarding a particular subject matter or matters. Notices will be sent by e-mail unless a mailing preference is noted in the request. A written request may be mailed or delivered to the person in 7 above or faxed to the office at (406) 444-3696, or may be made by completing a request form at any rules hearing held by the Department of Revenue.

10. An electronic copy of this notice is available on the department's web site at revenue.mt.gov/rules. The department strives to make the electronic copy of this notice conform to the official version of the notice, as printed in the Montana Administrative Register, but advises all concerned persons that in the event of a discrepancy between the official printed text of the notice and the electronic version of the notice, only the official printed text will be considered. While the department also strives to keep its web site accessible at all times, in some instances it may be temporarily unavailable due to system maintenance or technical problems.

11. The bill sponsor contact requirements of 2-4-302, MCA, apply for New Rule I and have been fulfilled. The primary sponsor of Senate Bill 251, Senator Art Wittich, was notified by regular mail on May 8, 2014, and subsequently notified on June 15, 2015.

12. With regard to the requirements of 2-4-111, MCA, the department has determined that the adoption, amendment, and repeal of the above-referenced rules will not significantly and directly impact small businesses. Documentation of the department's determination is available online at revenue.mt.gov/rules, or upon request from the person in 7.

/s/ Laurie Logan
Laurie Logan
Rule Reviewer

/s/ Mike Kadas
Mike Kadas
Director of Revenue

Certified to the Secretary of State July 6, 2015.